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# Countrywide deal may ease credit crisis

## *BofA's takeover is seen as a vote of confidence in housing long-term, but it isn't likely to stop the slide in values soon.*

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Bank of America Corp.'s milestone agreement to buy ailing Countrywide Financial Corp. was viewed Friday as a crucial step toward mending the battered housing and financial markets.

Analysts said the $4.1-billion deal was an aggressive bet by Bank of America on the long-term prospects of the housing sector, which had been roiled by falling prices and rising foreclosures.

With mounting losses from loan defaults, Countrywide had increasingly been subject to speculation that it would be forced into bankruptcy. That could have dried up a major source of mortgages, further weakening home values.

"This deal allows us to check off one more box that says we are successfully working our way through the credit crunch," said Jane Caron, an economist at Dwight Asset Management, an investment firm in Burlington, Vt. "This is another one of those milestones that helps put a floor under the mortgage and financial markets."

At the same time, economists said, the acquisition would do little in the months ahead to help homeowners whose property values were falling, investors whose stocks were sliding or workers whose job security was waning.

That view was echoed on Wall Street, where the Dow Jones industrial average sank almost 250 points as investors focused on the latest batch of evidence pointing to softening consumer spending and a darkening economic outlook.

"There are very serious ongoing problems in the housing market," said Stuart Gabriel, director of the Richard S. Ziman Center for Real Estate at UCLA. "They're not going to go away as a consequence of this deal. Those problems could worsen in the short run as it appears the economy is sliding into a recession, if not already in one."

In unveiling plans to buy Calabasas-based Countrywide, Bank of America Chairman and Chief Executive Kenneth Lewis acknowledged "the issues within the housing and mortgage industries."

But Lewis said the chance to acquire Countrywide gave the bank a "unique opportunity" to fulfill its longtime goal to become the dominant player in the home loan business.

Founded in 1969, Countrywide became the nation's largest provider of home loans under Chairman and co-founder Angelo R. Mozilo. But in recent months, it had become the highest-profile example of the mortgage meltdown as rising defaults triggered mounting financial losses and eventually pushed its stock price below $5, from about $45 a year ago.

As mortgage industry troubles spread last year, Mozilo repeatedly insisted that Countrywide would survive the shakeout and retain its top-dog position.

"Countrywide is a strong, viable financial company," he said just last month in an interview on financial news channel CNBC.

He struck a different tone in a memo to Countrywide employees Friday.

"We have come to recognize that those companies with reliable sources of capital and liquidity and significant scale will be the ultimate winners in this environment and in the longer term as the mortgage markets normalize," Mozilo wrote. "We also recognize that, as the industry changes and consolidates, we must embrace these changes."

The deal calls for Bank of America to buy all of Countrywide's stock for about $4.1 billion worth of its own shares. Countrywide stockholders will receive 0.1822 of a Bank of America share for each share they own.

Based on Thursday's closing price, the deal valued Countrywide at $7.16 a share, above the stock's 11-year low of $5.12 on Wednesday but below its close of $7.75 on Thursday, when it rallied on rumors of the deal.

Countrywide shares slumped 18% Friday to $6.33. Bank of America's stock declined 2% to $38.50, lowering the value of each converted Countrywide share to $7.01.

Bank of America said that it can reap annual cost savings of 11%, or $670 million, by combining Countrywide's mortgage unit and its own. About one-third of the savings will be gained in 2009 and two-thirds by 2010, with the full advantage recorded in 2011.

Company executives could not say what the effect would be on employees at Countrywide's headquarters in Calabasas or offices in Simi Valley and elsewhere. The company has more than 1,000 branch offices around the country and 50,600employees in total.

Acquisitions typically lead to layoffs, and Mozilo is likely to be among the first to go. "I would want him to stay until the deal gets done, and I would assume he would then want to go have some fun," Lewis said during a conference call.

Mozilo, one of the highest-paid executives in the country, stands to reap $115 million in severance-related pay, the company's regulatory filings show.

The deal is expected to close in six to nine months, pending approval of banking regulators and shareholders. The Countrywide name will be retained at first, but it could be dropped eventually, Bank of America spokesman Robert Stickler said.

Bank of America also said it would make only prime loans and then only to creditworthy customers. Countrywide already had phased out nearly all sub-prime loans, which were made to borrowers with weak credit histories. Defaults on these loans helped precipitate the mortgage meltdown last year.

It was unclear, however, whether other former Countrywide specialties involving riskier loans to people with prime credit scores would continue. Losses at Countrywide and other lenders are mounting sharply on these loans, which include home-equity second mortgages and adjustable-rate loans that allow borrowers to pay so little that the loan balance rises.

Lewis' bank has become the nation's largest retail, or direct-to-consumer, mortgage lender. However, Countrywide offers a wider range of mortgages, and Lewis said he might install areas in Bank of America branches where Countrywide workers would provide loans under the Countrywide name.

Bank of America also plans to continue Countrywide's wholesale lending operation, in which loans are made through independent mortgage brokers. Bank of America had exited the wholesale mortgage business as well as the so-called correspondent lending business, in which big lenders buy mortgages from smaller mortgage bankers. The latter business had produced some of the diciest loans of the entire mortgage fiasco.

The deal is perhaps the most visible in a series of steps that financial institutions have taken to overcome the bruising credit crunch that has stricken the U.S. economy.

In recent weeks, for example, several major Wall Street investment banks have secured multibillion-dollar infusions from foreign investors to ensure that they have the financial wherewithal to keep making loans.

Still, the mortgage business isn't expected to recover until the housing slump ends -- and that might not occur until 2009, said Douglas G. Duncan, chief economist of the Mortgage Bankers of America.

As prices fall, more people will find themselves owing more on their homes than they are worth. Foreclosures are the likely consequence.

"If you have no equity and 100% loan-to-value, your incentive to keep paying your mortgage is much less," Duncan said.

The growing number of homeowners who were "upside down" on their mortgages was also cited by Los Angeles economist Christopher Thornberg as a reason the housing market would continue to fall.

"We're entering a period of voluntary foreclosures," said Thornberg, who has one of the more pessimistic outlooks on housing. "Here's the 2008 real estate market in a nutshell. The sub-prime borrowers who could no longer make their payments and are out of their homes will be replaced by two groups of people: The walkaways, people who say, 'I'm not going to kill myself to pay a debt when the debt is larger than the asset.' The other is the unemployed."

Thornberg, principal of Beacon Economics, predicts that U.S. unemployment will climb to about 7% this year, up from the current two-year-high level of 5%.

"Historically, that's been big trouble for the mortgage industry," he said.

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